

**IN THE MATTER OF THE APPLICATION REGARDING CONVERSION  
OF PREMIERA BLUE CROSS AND ITS AFFILIATES**

Washington State Insurance Commissioner's Docket # G02-45

**PRE-FILED DIRECT TESTIMONY OF:**

**Sarah M.R. Jewell**

March 31, 2004

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**Introduction**

**Q. Please state your name, title, employer, and business address.**

A. Sarah (“Sally”) Jewell, Chief Operating Officer, REI, Inc. My business address is P.O. Box 1938, Sumner, Washington, 98390.

**Q. What is your relationship to Premera Blue Cross?**

A. I am an independent director of the PREMERA and Premera Blue Cross Boards of Directors. I have served on the PREMERA and Premera Blue Cross Boards since April 1995. I am currently Chair of the Governance Committee and a member of the Audit and Compliance Committee. During my nearly nine years as a Board member, I have chaired or served on every committee with one exception, the Quality Committee.

**Purpose and Conclusions of Testimony**

**Q. What is the purpose of your testimony?**

A. I will describe how the Board determined that Premera should convert to a for-profit. I will also explain why the Board believes that the proposed conversion is in the best interests of Premera, its customers, and the public.

**Q. What are the primary conclusions to be drawn from your testimony?**

A. The Board made the decision to convert after an extensive due diligence of Premera’s capital needs and the alternatives for enhancing its capital position to meet the needs of the company and its members. The Board stands firmly behind its conclusion that accessing the equity markets is the best way to strengthen Premera’s capital position, to serve an increasing number of members, and to continue investing in its infrastructure and technology. Finally, the conversion will be good not only for Premera and its subscribers, but also for the public. A pool of hundreds of millions of dollars will be

1 created by the conversion, dedicated to the healthcare needs of the citizens of Washington  
2 and Alaska.

3 **Qualifications**

4 **Q. Please summarize your educational background.**

5 A. In 1978 I received a BS degree in Mechanical Engineering from the University of  
6 Washington, Cum Laude. Since then, I have supplemented my formal education with  
7 business and leadership courses.

8 **Q. Please summarize your business background.**

9 A. I am currently the Chief Operating Officer of REI. Previously, I served as  
10 Executive Vice President of Washington Mutual Bank, President and Chief Executive  
11 Officer of its commercial banking group, and in various positions with West One Bank of  
12 Washington, Security Pacific Bank, Rainier Bank, and Mobil Oil.

13 **Q. Aside from your employer and Premera, what organizations are you active  
14 in?**

15 A. I am a Regent of the University of Washington, currently serving as chair of the  
16 Capital Assets Committee and as a member of the Finance and Audit Committee. In  
17 addition, I am the President of the Mountains to Sound Greenway Trust Board; a member  
18 of the Governor's Competitiveness Council; and a member of the steering committee for  
19 the Seattle Initiative for Global Development. I am also active with the Alliance for  
20 Education, the YWCA, the Puget Sound Blood Center, and the Girl Scouts. On the  
21 corporate side, I sit on the REI board, and I am a former board member of Avista  
22 Corporation, a New York Stock Exchange-listed company based in Spokane.  
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**Premera Board's Rationale for Supporting Conversion to For-Profit**

**Q. What circumstances led the Board to decide that Premera should convert to a for-profit company?**

A. The Board has periodically assessed the issues surrounding the company's capital levels since I became a board member in 1995. During my tenure on the Board, the company has undertaken several initiatives to improve its capital position. During the mid to late 90's Premera's primary focus was to turn the company around financially. Once the turnaround was achieved, the company focused on improving its products and services to meet the evolving demands of its customers. As the company's financial position improved, and with the prospect of continued membership growth, the Board began to focus on the long term capital needs of the company. In 2001, the Board again considered the alternatives for increasing capital and in late 2001 authorized management to conduct the necessary due diligence and to develop a plan for a potential conversion to for-profit status.

To elaborate, I attended my first Board planning retreat in 1995, during which we had extensive discussions about Premera's capital position. In the mid- to-late- '90s, Premera was losing money and its statutory capital was declining.

Premera's losses in the 1990's were largely the result of regulatory mandates related to the health insurance market for individuals. As a result of the mandates, Premera experienced significant underwriting losses in the individual line of business, which placed pressure on the company's capital position. During this same time period, several national health insurers left the State of Washington.

In 1997, the Board retained Goldman Sachs, which reviewed Premera's business structure, as well as its financial and capital position. After a series of discussions, and

1 consistent with the advice of Goldman Sachs, the decision was made to merge Blue Cross  
2 of Washington and Alaska (“BCWA”) and Medical Services Corporation of Eastern  
3 Washington (“MSC”), which had operated as affiliates in Washington since 1994. The  
4 merger, which was completed in 1998, proved beneficial by providing financial and  
5 operational integration of the two companies.

6 During the late 90’s the company focused on improving its ability to serve  
7 customers and complete its financial turnaround. In 1999, the company returned to  
8 operating profitability. In 2000, the company launched its Business and Systems  
9 Transformation initiative to redesign the company’s products, operations and systems.  
10 That initiative resulted in a new core information system and the Dimensions suite of  
11 products. The capital to support this project was raised through a series of sale and lease-  
12 back arrangements.

13 As Premera continued to grow, and with the potential for future growth based on  
14 the company’s improved information systems and new products, the Board became  
15 acutely aware that every new customer required Premera to increase its capital reserves.  
16 The more the company grows, the greater its need for capital to support that growth. For  
17 this reason, and recognizing that Premera’s capital level is among the lowest in the Blues  
18 system, the Board continued its discussions about what the prudent capital level should  
19 be for Premera. In 2001, we began an in-depth review of our alternatives for enhancing  
20 capital. After a series of Board meetings, and with the assistance of independent  
21 financial and legal advisors, the Board reached a decision in May 2002 that Premera  
22 should convert, and authorized management to initiate discussions with state officials.  
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1 **Q. Please summarize the process that the Board used in reaching its decision.**

2 A. Let me begin by saying that the process the Board followed in deciding that  
3 Premera should convert to a for-profit company has been one of the most diligent,  
4 methodical, and thorough processes I've witnessed as a board member in any  
5 organization. The process began in August 2001 and culminated in May 2002.

6 During the August 2001 board meeting, Goldman Sachs gave us their assessment  
7 of Premera's financial situation, an update on market dynamics, and a review of options  
8 for raising capital. In our September 2001 planning retreat, Goldman Sachs presented an  
9 in-depth evaluation of capital funding options, including a conversion to for-profit status.  
10 The Board determined that the concept of conversion had merit. We authorized  
11 Premera's management to assist the Board in its due diligence in reviewing, assessing  
12 and deciding whether to pursue a conversion.

13 Over the next eight months, we held a series of regular and special board sessions,  
14 with the participation of our outside advisors, dedicated to an in-depth study of  
15 conversion, how it might be accomplished, Premera's attractiveness as a public company,  
16 and the specific proposal that was approved at the May 2002 meeting.

17 Based upon all of the information presented and the Board's deliberations during  
18 the course of the previous meetings, the Board unanimously endorsed the decision to  
19 move forward with conversion.

20 **Q. In addition to converting to a for-profit company, what alternative means of  
raising capital did the Board consider?**

21 A. We looked at several alternatives, some of which could be pursued as a non-profit  
22 entity, and some that would result in converting to for-profit status. We used several  
23 criteria to screen each of the alternatives. Those criteria included overall feasibility, the  
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1 amount of additional statutory capital that could be raised; whether Premera would  
2 maintain its BCBSA license; and whether the alternative would support Premera's  
3 growth strategy and improve its financial strength and flexibility.

4         One of the alternatives we considered and ruled out was a merger. We believe  
5 that Premera does not have much to gain from merging with another health plan at this  
6 time. The company has strong management, a solid game plan, a vision for serving its  
7 customers, and a bright future. We're putting new systems in place, streamlining  
8 operations, and improving service to members. We are seeking access to capital to  
9 enhance the company's ability to achieve its mission and vision. We believe that we can  
10 serve our customers well and avoid the risks inherent in a merger by remaining  
11 independent and responsible for our own decisions.

12         The Board considered selling fixed assets or operating units, but decided against  
13 those options. Premera's significant assets are all integral components of the company's  
14 business strategy. Asset sales are also just a one-time source of funds and do not provide  
15 on-going access to capital. In addition, Premera has completed several asset  
16 sale/leaseback arrangements over the last several years, so the opportunities for obtaining  
17 more statutory capital in that fashion are limited.

18         We evaluated the option of taking on debt. The only debt which qualifies as  
19 statutory capital is subordinated debt in the form of surplus notes. However, the amount  
20 of surplus debt that counts as statutory capital is limited to a small percentage of existing  
21 statutory capital.

22         In the end, the Board concluded that converting to for-profit status made the most  
23 sense. It will allow Premera to raise capital without losing its independence,  
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1 cannibalizing its operations, or taking on unnecessary debt. It also provides ongoing  
2 access to capital.

3 **Q. Was the decision to convert approved by the Board unanimously?**

4 A. Yes, it was.

5 **Q. Please summarize why the Board voted in favor of Premera's conversion to  
6 for-profit.**

7 A. The Board concluded that a conversion is prudent to strengthen the company's  
8 capital position. Our reasoning is straightforward. Premera's current capital position is  
9 among the lowest of any Blue plan. We are well positioned to grow our membership,  
10 which will bring our products and services to more members. But that will require more  
11 capital. In evaluating the alternatives for raising capital, the Board concluded that the  
12 most viable option by far was to access the equity markets through a conversion to for-  
13 profit status. The additional capital will give Premera the financial resources to support  
14 membership growth while continuing to invest in information systems, new products, and  
15 programs that improve the quality of service to members. The conversion will also  
16 provide hundreds of millions of dollars dedicated to the healthcare needs of our state.

17 **Q. Premera is not currently in crisis, so is there really a compelling business  
18 case for conversion?**

19 A. Companies in crisis have very limited options. The best time to raise capital is  
20 when a company can demonstrate a successful business strategy and a formula for  
21 growth. Premera has demonstrated its ability to serve its customers. Acquiring  
22 additional capital will enable the company to continue its success by keeping local  
23 decision-making. The Board believes this is in the long-term best interests of the  
24 company, its customers, and the community. One of our expert witnesses, Banc of

America Securities, said it well: “successful companies pursue capital before they need it.” That’s the situation we’re in.

Can Premera reach its full potential without access to capital? Premera’s goal is to be the health plan of choice and the standard of excellence in its region. Accessing capital will allow us to pursue that goal to the benefit of members and the public.

### **Conversion Impact**

**Q. Some have suggested that Premera wants to convert to for-profit to enrich management or its executive team. What is your response to that?**

A. The Board, not management, made the decision to convert to for-profit status. The Board’s decision was in no way motivated by a desire to enhance executive compensation. The Board is very mindful of its responsibilities with respect to executive compensation, as was the case before the decision to convert. In the course of the conversion process, the Board took care to make sure that any post-conversion compensation programs are established in accordance with best practices.

The Board has not changed its compensation philosophy as part of the conversion decision. We seek to attract and retain well-qualified individuals to Premera’s management team while setting compensation and benefits programs which are consistent with market practice.

### **Public Benefits of the Conversion**

**Q. As a civic leader, what potential benefits do you believe the conversion will have for Washington residents?**

A. Like the rest of the country, we have substantial unmet healthcare needs in the state of Washington. As a University of Washington Regent, I am particularly aware of these challenges as they impact both the UW Medical Center and Harborview Hospital,

1 which provide the lion's share of indigent care in King County. Training adequate  
2 numbers of nurses, physical therapists, and other healthcare providers is also a major  
3 issue, particularly as the population ages. The list of needs is a long one.

4       Unlocking the value of Premera to create a pool of hundreds of millions of dollars  
5 dedicated to healthcare in Washington and Alaska would be an enormous benefit to our  
6 communities. In his expert report Lewis Reid, the former president of The California  
7 Endowment, noted that "the amount per capita available to health philanthropy in  
8 Washington and Alaska [from a Premera conversion] would be roughly equivalent to ...  
9 the largest foundation ever created by a Blue Cross Blue Shield conversion."

10       Given the needs in our state, it would be exceedingly disappointing to pass up the  
11 philanthropic benefits that the conversion will bring.

12       At the same time, we have an opportunity to strengthen Premera's financial  
13 position through the conversion, which will benefit the company's current and future  
14 members. The Board believes Premera has the right management, the right strategy, and  
15 the right market conditions to operate the business successfully.

16       With the conversion, all sides win – Premera's customers, the company, and the  
17 public. I believe, as does the rest of the Board, that the facts mandate approval of  
18 Premera's proposal. For all the reasons set forth above, I urge the Commissioner to  
19 approve the conversion.

20 **Q.     Does this conclude your testimony?**

21 **A.     Yes, it does.**  
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